

TO: Finance and Personnel Committee

DT: October 31, 2008

FM: Herbert Pike, Finance Director

Re: Audited Financial Reports
--June 30, 2008

Auditors from Maze & Associates will present the following audited financial reports for the fiscal year ended June 30, 2008:

1. **Basic Financial Reports**-Overall financial reports for ABAG presenting the financial position and results of operation for FY 07-08. These reports include:
 - Management's Discussion and Analysis
 - Statement of Net Assets
 - Statement of Activities
 - Statement of Cash Flows
2. **Management Letter**-Auditor's report on the Association's internal control.
3. **Single Audit**-An audit of the Association's Federal grant awards as required by the Single Audit Act as amended in 1996 and OMB Circular A133.

Summary of Audit Results:

The auditors issued an unqualified opinion on the above reports. There were no audit findings or adjustments to the financial reports.

As stated in the Management Letter, the auditors did not identify any material weaknesses in the Association's internal control.

In the Single Audit Report, there were no audit findings or questioned costs.

**ASSOCIATION OF
BAY AREA GOVERNMENTS
BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

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**ASSOCIATION OF BAY AREA GOVERNMENTS
BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

Table of Contents

	<u>Page</u>
INTRODUCTORY SECTION	
Table of Contents	i
FINANCIAL SECTION	
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements	
Statement of Net Assets	16
Statement of Activities	17
Statement of Cash Flows	18
Notes to Financial Statements	19

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INDEPENDENT AUDITORS' REPORT

The Executive Board
Association of Bay Area Governments
Oakland, California

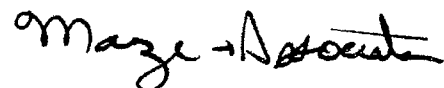
We have audited the basic financial statements of each major fund of the Association of Bay Area Governments (Association) for the year ended June 30, 2008, which collectively comprise the Association's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly in all material respects the respective financial position of each major fund of the Association at June 30, 2008, and the respective results of its operations and cash flows for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 26, 2008 on our consideration of the Association of Bay Area Governments internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



September 26, 2008

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MANAGEMENT'S DISCUSSION AND ANALYSIS

The Association of Bay Area Governments (Association) has issued the financial reports for fiscal year ending June 30, 2008 based on the provisions of the Government Accounting Standards Board Statement 34, "Basic Financial Statement and Management's Discussion & Analysis—for State and Local Governments," (GASB 34). One of the most significant requirements of GASB 34 is for government entities to prepare financial reports using the full accrual basis of accounting. Since the Association has already been using this method of accounting, changes in its financial reports are primarily in format of presentation.

GASB 34 requires the Association to provide an overview of financial activities in the fiscal year and it should be read in conjunction with the accompanying financial statements.

BASIC FINANCIAL STATEMENTS

The Basic Financial Statements required under GASB 34 include:

1. Statement of Net Assets—provides information about the financial position of the Association, including assets, liabilities and net assets. The difference between this statement and the traditional Balance Sheet is that net assets (fund equity) are shown as the difference between total assets and total liabilities.
2. Statement of Activities—presents revenues, expenses and changes in net assets for the fiscal year. It differs with the traditional Statement of Revenues and Expenses in that revenues and expenses directly attributable to operating programs are presented separately from investment income and financing costs.
3. Statement of Cash Flows—provides itemized categories of cash flows. This statement differs from the traditional Statement of Cash Flows in that it presents itemized categories of cash in flows and out flows instead of computing the net cash flows from operation by backing out non-cash revenues and expenses from net operating surplus/deficit. In addition, cash flows related to investments and financing activities are presented separately.

The Basic Financial Statements above provide information about the financial activities of the Association's three programs—ABAG, ABAG Finance Corporation and BALANCE Foundation, each in a separate column instead of in summary form, as in the past.

FISCAL YEAR 2008 FINANCIAL HIGHLIGHTS

Financial highlights of the year include the following:

- The Association's total assets were \$5.5 million at June 30, 2008. At June 30, 2007, total assets were \$5.7 million.
- The Association's total revenues, including program and general revenues, were \$17.5 million in FY 2008, while total expenses were \$17.2 million.

- The Association's total net assets increased \$357 thousand in FY 2008 to a new total of \$2.1 million at June 30, 2008. This figure includes Restricted Net Assets of \$168 thousand in the BALANCE Foundation designated for the Tranter-Leong Internship Program.
- ABAG program operating revenues were \$17.4 million in FY 2008, while ABAG Finance Corporation operating revenues were \$1 thousand and BALANCE Foundation operating revenues were \$84 thousand.
- ABAG program operating expenses were \$17.0 million in FY 2008, while ABAG Finance Corporation operating expenses were \$8 thousand and BALANCE Foundation operating expenses were \$65 thousand.
- General revenues and expense, was a net revenue of \$1 thousand in total, of which \$26 thousand of net interest expense was realized by the ABAG program, \$27 thousand in net revenue was reported by the BALANCE Foundation, including the receipt of \$20 thousand in restricted donations designated for the Tranter-Leong Internship Program.
- ABAG net assets were \$1.6 million at June 30, 2008, while ABAG Finance Corporation net assets were \$88 thousand and BALANCE Foundation net assets were \$373 thousand at that date.

CAPITAL ASSETS

At June 30, 2008, the Association had \$320 thousand, net of depreciation, invested in capital assets, principally including its share of the MetroCenter Facility. Further details of the Association's capital assets are presented in Note 3 to the financial statements.

DEBT ADMINISTRATION

The Association issued no new debt in FY 2008, repaid \$225 thousand of its debt and ended the fiscal year with a \$245 thousand balance in long-term debt outstanding as of June 30, 2008. The Association's long-term debt balances and transactions are discussed in detail in Note 4 to the financial statements.

MAJOR PROGRAM INITIATIVES IN FY 2008 AND OUTLOOK FOR FY 2009

We are happy to report the following accomplishments in FY 2008 and goals for FY 2009:

Planning Programs

1. In collaboration with the Metropolitan Transportation Commission (MTC), continued to work on Focusing the Bay Area Vision, funded by the Federal Department of Transportation through Cal-Trans to develop a Regional Blueprint for the Bay Area. Focus is in its third year, and has become a major undertaking.
2. Through the Regional Planning Committee, one of the standing committees of the ABAG Executive Board, continued to work with member jurisdictions and other stakeholders on issues and solutions with affordable housing, education, environmental protection, the home building industry, and smart growth.

3. Continued to work with the Regional Airport Planning Commission, a joint committee of ABAG, the Metropolitan Transportation Commission (MTC), and the Bay Conservation and Development Commission (BCDC), on the preparation of the Regional Airport Systems Analysis, which then becomes part of the Regional Transportation Plan.
4. With grants from the State Water Quality Control Board, ABAG is offering evaluation and planning of water resources mapping, watersheds, water infrastructure and related land uses.

In FY 2009 the Planning Program will:

1. ABAG will address a variety of challenging issues pertaining to infill development in transit-served neighborhoods including affordable housing, attracting viable retail services, incorporating parks and urban greening, and integrating pedestrian amenities and transit infrastructure.
2. Planning staff will serve as networking facilitators among the ongoing Priority Development Area planning efforts.
3. Will adopt the first set of Priority Conservation Areas and work with public and private agencies to secure funding for the protection of the adopted areas.
4. The Regional Planning Committee will address and make policy recommendations to the Executive Board pertaining to important regional planning issues including considerations relative to Focus Priority Development Areas and Priority Conservation Areas and the development of programs related to Regional Recovery Planning.
5. Continue to work with the Regional Airport Planning Committee to address land use and environmental issues.
6. Collaborate with local governments and other partners to advance a joint agency Regional Climate Change Initiative.
7. Continue to serve as clearinghouse for tracking of public projects to allow review and discussion of regionally significant issues.
8. Work with local governments and other partners to address land use and water resource issues, and to develop information sources, tools and techniques to help Bay Area communities in meeting their water and land use planning goals.

Bay Alliance for Sustainable Communities (Bay Area Alliance)

ABAG represents the Bay Area cities and counties in the Steering Committee of the Bay Area Alliance, a consortium of both public and private agencies founded in 1997 with a goal of working together for a sustainable future.

1. In collaboration with the Bay Area Alliance, published the “Building Communities We Care About,” a video that features the successful transit-oriented housing developments in the Bay Area.

In FY 2009 the Bay Area Alliance will:

1. Implement key provisions of the Compact for a Sustainable Bay Area.
2. Conduct targeted outreach using Building Communities We Care About to promote transit-oriented developments and smart growth.
3. Participate in identifying funding for the Priority Development Areas.
4. Promote the development of comprehensive climate change plans and policies.

Hazardous Waste Allocation/Bay Area Green Business Program

1. Through the Hazardous Waste Management Facility Allocation Committee, a committee comprising county representatives, continued to oversee the implementation of a “fair share” facility allocation process, the Bay Area Green Business Program, and other critical regional hazardous waste management issues.
2. Analyzed data and reports on hazardous wastes generated in the region, and developed source reduction recommendations.
3. Supported local and statewide efforts to promote Extended Producer Responsibility, which would shift the responsibility for recycling or disposing hazardous products from local governments back to manufacturers.
4. Supported the Department of Toxic Substances Control’s Green Chemistry Initiative, which seeks to ensure that products are manufactured with little or no hazardous/toxic substances.
5. Launched in 1996, the Green Business Program has certified 1,100 businesses and public agencies. Now considered a model, the Program is expanding statewide.

In FY 2009 the Hazardous Waste Allocation/Bay Area Green business Program will:

1. Monitor and support legislative and other efforts to address universal wastes through Extended Producer Responsibility and other mechanisms.
2. Participate in and support Cal EPA/DTSC's Green Chemistry Initiative to promote more environmentally responsible project design that minimizes hazardous and other wastes.
3. Increase the number of certified green businesses in the Bay Area to 1,500.
4. Develop a web-based measurement system to track environmental benefits of Green Business participation.

San Francisco Bay Trail

1. In FY 2008, the Bay Trail reached an important milestone—300 miles of completed trail around San Francisco Bay. The vision of this program is a 500-mile continuous trail along the edge of San Francisco Bay.
2. A \$3 million grant from the State was awarded to ABAG for Bay Trail planning and construction.

In FY 2009 the San Francisco Bay Trail will:

1. In partnership with the Coastal Conservancy, solicit, review and award grants to local jurisdictions for construction of Bay Trail segments.
2. Administer awarded Bay Trail construction grant contracts.
3. Pursue new funding for project administration, trail development, and maintenance.
4. Develop new Bay Trail segments by participating in the South Bay Salt Pond Restoration Planning Project.
5. Expand the Wildlife and Public Access Study.
6. Advocate for bicycle and pedestrian access to and across Bay Area toll bridges.
7. Publish the Bay Trail Rider newsletter; establish a functional Bay Trail website.
8. Update and use the Gap Analysis Study data to identify and initiate new Bay Trail opportunities and new candidates for Bay Trail grants.

San Francisco Estuary

1. Using the Comprehensive Conservation and Management Plan (CCMP) as a blueprint for action, the Estuary Project and its many partners have completed a range of activities from technical and scientific research to public education and outreach.
2. Completed projects: the Brake Pad Partnership, Urban Pesticides, Pollution Prevention, and Tools for Surface Water Monitoring.
3. Continued to work on the multi-year project to develop recommendations to reduce methyl mercury in the Bay Area wetlands.
4. Worked with the Regional Water Quality Control Board (RWQCB) and other partners to complete a stream and wetland protection policy for the San Francisco Bay Area and the North Coast.
5. Worked with partners to prevent invasive species in the Estuary through a signage program describing the need for spartina eradication, and through the completion of a statewide Management Plan for Aquatic Nuisance Species.
6. Offered technical support services to the Santa Clara Valley Water District, Alameda and the San Francisco Public Utilities Commission.
7. Started a \$2.6 million multi-year program funded by the RWQCB to implement Total Maximum Daily Loads (limiting pollutants into waterways of the State).
8. Through the Boater Education Program, published Estuary Newsletter, and offered erosion control workshops.

In FY 2009 the San Francisco Estuary Project will:

In addition to continuing projects mentioned above:

1. Under the Cal Fed Bay Delta Program, offer the three-day 5th biennial Science Conference in October (1200 estimated attendees); work with the Urban Pesticide Committee to reduce pesticide use in urban creeks; publish the 2008 State of the Estuary Report.
2. Work with partners to develop the application of the State's Watershed Assessment Framework as a tool for integrating and communicating watershed health indicators for the San Francisco Estuary.
3. Work with BCDC, the California Coastal Conservancy, and NOAA on the San Francisco Bay Subtidal Habitat Goals Project, a collaborative interagency effort

to establish a comprehensive and long-term management vision for the San Francisco Bay Subtidal Habitats.

Earthquake and Hazard Mitigation and Recovery

1. Coordinated completion of the multi-jurisdictional local Hazard Mitigation Plan for 26 local governments.

In FY 2009 Earthquake and Hazard Mitigation and Preparedness will:

1. Identify inadequately designed levees in the San Francisco Bay and work to develop cost-effective and environmentally sensitive disaster mitigation strategies for critical infrastructure systems protected by these levees.
2. Develop ways to improve earthquake retrofitting of single-family homes including sponsoring legislation, and encourage retrofit of multi-family housing in "soft story" buildings (buildings with open first floors such as parking spaces).
3. Advocate mandatory retrofit of un-reinforced masonry buildings in the downtown areas of cities.
4. Promote adoption of hazard mitigation planning by additional local governments, and true recovery planning on the part of all local government departments, not just emergency services.

Data and Analysis

1. Completed the Projections 2008 short-term economic forecast, a two-year view of county and regional economic data including ABAG's index of leading regional indicators and retail sales forecast.
2. Started work on the Projections 2009, the biennial long-term economic forecast providing the basic economic and demographic forecast data through 2035.
3. Started work on improving forecast computer models to provide results that are more accurate, more extensive and better coordinated with the transportation models used by MTC.
4. Completed the 2008 Housing Report, an annual report that tracks production of various types of housing in the region, including information on housing prices and changes in the housing market.
5. Started work on the Regional Housing Needs Allocation (RHNA) for the Bay Area.

6. Held conferences and workshops during the year to brief local governments, business, and community stakeholders on the highlights and implications of the forecasts produced.

In FY 2009 Data and Analysis will:

1. Finalize Projections 2009, the biennial long-term economic forecast.
2. Complete the RHNA and present results to local governments for preparation of their housing elements.
3. Continue to work on improving computer models that are better coordinated with MTC's transportation models.
4. Conduct workshops for local governments and other stakeholders.

ABAG Publicly-Owned Energy Resources (POWER)

1. In its eleventh year of operation, ABAG POWER has been providing natural gas aggregation services to currently 38 local governments and special districts in the Pacific Gas and Electric (PG&E) territory.
2. Began work on the ABAG Energy Watch program, a partnership with PG&E designed to assist local governments to achieve energy and cost savings by improving energy efficiency in public facilities. To date, 62 cities, counties and special districts within the Bay Area have enrolled to receive assistance from the program.

In FY 2009 ABAG POWER will:

1. Continue to explore various natural gas purchasing strategies with the objective to enhance price stability.
2. Through the in-house billing and analysis system, propose strategies that will reduce energy costs through conservation and usage management.
3. With the grant contract from PG&E, the ABAG Energy Watch program will continue to work with local government entities on strategies to improve energy efficiency.
4. Assist local agencies in climate protection issues, such as meeting their greenhouse gas reduction goals.

Insurance Pool Programs

1. Organized in 1986, the ABAG Pooled Liability Assurance Network (PLAN) Corporation continued to provide general liability and property insurance to currently 31 cities and towns in the Bay Area. Total assets of PLAN have grown to exceed \$50 million.
2. PLAN offered assistance to local governments in risk management programs, including the Sewer Smart Program, as well as other training and incentive-based loss prevention programs.
3. Since 1989, the ABAG Comp Shared Risk Pool (SHARP) continued to offer workers comp insurance pool as an alternative to commercial insurance policies to currently four local government jurisdictions.

In FY 2009 the Insurance Pool Programs will:

1. These insurance pools will continue to offer consistent coverage limits, stable premiums, loss prevention programs, and assistance in litigation management to pool member jurisdictions.

ABAG Financial Services

1. To date, ABAG Financial Services has provided a total of more than \$7 billion in low cost capital financing for more than 200 California government jurisdictions and their non-profit partners.
2. Residents in borrowing government jurisdictions benefit from Association financing projects in many ways, including construction of new hospitals, mass transit systems, schools, water and wastewater systems, and museums.
3. Association financings have funded construction and preservation of more than 10,000 housing units in more than seventy affordable apartment communities.

In FY 2009 ABAG Financial Services will:

1. Provide economical funding for developers of affordable multi-family housing, independent schools, hospitals, and other voluntary healthcare providers through ABAG Finance Authority for Non-profit Corporations.
2. Expand the Finance Authority's capital lease financing services through the Authority's long-standing Credit Pooling Program, providing an economical source for funding equipment and smaller capital projects.
3. Continue to offer comprehensive services to meet the land development financing needs of member agencies and special districts.

ABAG Training Center

1. Over the past few years, we have experienced a shift in training needs of ABAG members to practical, certificate courses in worker safety, hazardous waste management, pollution prevention, and computer technology. As a result, the overwhelming majority of our courses currently offered are in Occupational Safety and Health Administration (OSHA) required safety training.
2. The development of the Internet allowed us to offer courses not only to employees of Bay Area local governments, but also to students throughout the entire country. In 1999, ABAG established a web-based identity—Online Hazmat School. We had 125 online enrollments during its first year, growing rapidly to about 7,500 in FY 2008 and 39,000 since inception.
3. Since 2002, ABAG has been an authorized Continuing Education Unit (CEU) provider of the International Association for Continuing Education Training (IACET).
4. In 2004, ABAG was awarded a Federal GSA contract, which places ABAG Online Hazmat School on the authorized training provider selection list for Federal employees.

In FY 2009 ABAG Training Center will:

1. Update course contents to make our training more valuable to returning students who are required to take annual refresher courses.
2. Package courses in unique ways for specific industries, and improve course selection so that students can easily select courses that best serve their needs.
3. Develop marketing strategies to target specific industries.

ABAG Web Services

1. The ABAG website was redesigned in 2006 with a new layout to offer a wealth of information to the general public, including earthquake mitigation and hazard maps, Bay Trail maps, the Green Business Program, the San Francisco Estuary Program, ABAG Financial Services, ABAG POWER, ABAG PLAN, the Smart Growth Initiative, and other demographic and economic data.
2. The online Geographical Information System (GIS), allows the public to obtain information by clicking locations on maps, such as earthquake hazard maps.
3. The Association offers Internet hosting services to local governments and other public agencies. We also created customized websites for clients such as the Alameda County Transportation Improvement Authority, the San Francisco Bay

Water Transit Authority, the CALFED Science Program, the cities of Fairfax and Belvedere, and the Delta Diablo Sanitation District.

4. To better serve our clients with publication purchases, class or workshop registration, the Association uses an electronic merchant software system. This level of automation has automated processing of higher volume orders from our clients and saved staff cost.
5. In collaboration with the California State Association of Counties (CSAC), implemented a business recovery solution by placing backup servers at the CSAC offices in Sacramento. This backup system would provide continued limited critical operations in the event of business disruption at the ABAG offices caused by a variety of disasters.
6. In cooperation with MTC, implemented anti-spam protection and additional security measures to our network. We also consolidated servers to conserve space and reduce energy usage.

In FY 2009 ABAG Web Services will:

1. All the above initiatives will continue in FY 2009.

Legislative Activities

1. Working with the Legislative and Government Organization (L&GO) Committee, a sub committee of the ABAG Executive Board, identified four critical regional issues to track during the next California legislative session: bills on transportation efficiency and related land use policy, water quality management, extended producer responsibility, and policy solutions addressing global warming.
2. During FY 2007 session, fifteen of the state bills that the L&GO Committee had recommended support or opposition became law. These bills encompassed a wide variety of housing element, transit-oriented infill and redevelopment issues, and other important regional matters.

In FY 2009 Legislative Activities will:

1. Increase legislative advocacy and outreach to Bay Area legislators, briefing them on issues and policy solutions critical to the Bay Area.
2. Track legislation affecting housing and land use, local government finance, environment and water quality, and policy solutions that address global warming.
3. Monitor closely unfunded mandates and fiscal impacts on local governments.

Other Initiatives

1. In March 2008, the Executive Board approved the final version of a Long-term Strategic Plan, with the objectives of:
 - Identifying and securing predictable and reliable long-term funding;
 - Establishing a more effective regional voice representing Bay Area jurisdictions in Sacramento, Washington and other policy arenas; and
 - Developing a plan to increase the Association's responsiveness to, and accountability for, addressing the diverse needs of member jurisdictions.
2. Offered in August 2007 our second symposium on "The Challenges of Other Post Employment Benefits (OPEB)" to assist local governments and special districts to plan for and implement this complex new accounting requirement as stipulated in Government Accounting Standards Board (GASB) Statement #45.
3. In October 2007, ABAG and MTC jointly offered a conference titled "Bay Area on the Move" to address connecting transportation, land use and climate protection.
4. To provide visibility for our members who are effectively advancing the cause of Smart Growth and Focus Initiatives, ABAG launched the 2007 "Growing Smarter Together" awards program. The member jurisdictions that were recognized for best practice efforts were recognized in a special video presentation at ABAG's Spring General Assembly.
5. The General Assembly to be held in October 2008 titled: "Regional Water-Land Use Planning: The Delta Connection," will address critical water and land use policies and environmental challenges impacting the Bay Area and Delta.

CONTACTING THE ASSOCIATION'S FINANCIAL MANAGEMENT

This financial report is intended to provide citizens, taxpayers, creditors, and stakeholders with a general overview of the Association's finances. Questions about this report may be directed to the ABAG Finance Department, at 101 Eighth Street, Oakland, California 94607.

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ASSOCIATION OF BAY AREA GOVERNMENTS
STATEMENT OF NET ASSETS
JUNE 30, 2008

	<u>Association of Bay Area Governments</u>	<u>ABAG Finance Corporation</u>	<u>BALANCE Foundation</u>	<u>Total</u>
ASSETS				
Cash and Investments (Note 2):				
Cash and Cash Equivalents	\$1,681,480	\$28,532	\$375,416	\$2,085,428
Receivables:				
Federal, State and Local Grants	2,500,693			2,500,693
Interest	7,474		1,533	9,007
Prepaid Expenses and Other	<u>155,970</u>	<u>59,252</u>		<u>215,222</u>
Total Current Assets	4,345,617	87,784	376,949	4,810,350
Noncurrent Assets				
Cash with Fiscal Agent (Note 2)	400,588			400,588
Capital Assets, Net of Accumulated Depreciation (Note 3)	<u>320,127</u>			<u>320,127</u>
Total Assets	<u>5,066,332</u>	<u>87,784</u>	<u>376,949</u>	<u>5,531,065</u>
LIABILITIES				
Current Liabilities				
Accounts Payable	974,905		4,416	979,321
Compensated Absences (Note 1E)	438,632			438,632
Other Accrued Liabilities	265,015			265,015
Current Portion of Long-Term Debt (Note 4)	225,000			225,000
Deferred Revenue	<u>1,290,700</u>			<u>1,290,700</u>
Total Current Liabilities	<u>3,194,252</u>		<u>4,416</u>	<u>3,198,668</u>
Noncurrent Liabilities				
Long-Term Debt, Net of Current Portion (Note 4)	<u>245,000</u>			<u>245,000</u>
Total Liabilities	<u>3,439,252</u>		<u>4,416</u>	<u>3,443,668</u>
NET ASSETS (Note 7)				
Restricted			168,389	168,389
Unrestricted	<u>1,627,080</u>	<u>87,784</u>	<u>204,144</u>	<u>1,919,008</u>
Total Net Assets	<u>\$1,627,080</u>	<u>\$87,784</u>	<u>\$372,533</u>	<u>\$2,087,397</u>

See accompanying notes to basic financial statements

ASSOCIATION OF BAY AREA GOVERNMENTS
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2008

	Association of Bay Area Governments	ABAG Finance Corporation	BALANCE Foundation	Total
PROGRAM OPERATING REVENUES				
Grants	\$9,942,243			\$9,942,243
Charges for Services	5,650,395	\$1,441	\$1,990	5,653,826
Membership Dues	1,528,146			1,528,146
Donations - Unrestricted	178,580		81,968	260,548
Other	65,113			65,113
Total Program Operating Revenues	17,364,477	1,441	83,958	17,449,876
PROGRAM OPERATING EXPENSES				
Salaries and Related Benefits	9,453,452			9,453,452
Consultant Services	5,775,657	7,914	45,944	5,829,515
Equipment, Maintenance and Supplies	194,177		218	194,395
Outside Printing Costs	146,760			146,760
Conference and Meeting Costs	264,500			264,500
Depreciation	238,336			238,336
Building Maintenance	208,563			208,563
Postage	69,943			69,943
Insurance	137,439			137,439
Telephone	47,704			47,704
Utilities	66,735			66,735
Committee	68,100			68,100
Other	348,813		19,162	367,975
Total Program Operating Expenses	17,020,179	7,914	65,324	17,093,417
Net Program Operating Income	344,298	(6,473)	18,634	356,459
GENERAL REVENUE (EXPENSE)				
Interest Income	51,958	70	7,365	59,393
Interest Expense	(78,303)			(78,303)
Donations - Restricted for Internship Program			19,698	19,698
Total General Revenue (Expense)	(26,345)	70	27,063	788
Change in Net Assets	317,953	(6,403)	45,697	357,247
Beginning Net Assets	1,309,127	94,187	326,836	1,730,150
Ending Net Assets	\$1,627,080	\$87,784	\$372,533	\$2,087,397

See accompanying notes to basic financial statements

ASSOCIATION OF BAY AREA GOVERNMENTS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008

	Association of Bay Area Governments	ABAG Finance Corporation	BALANCE Foundation	Total
CASH FLOWS FROM OPERATING ACTIVITIES				
Grant receipts	\$10,098,839			\$10,098,839
Receipts from customers and members	7,355,717	\$1,441	\$83,958	7,441,116
Payments to contractors and members	(6,779,940)		(45,386)	(6,825,326)
Payments to employees	(9,453,452)			(9,453,452)
Payments to committees	(68,100)			(68,100)
Other receipts (payments)	<u>(283,700)</u>		<u>(19,162)</u>	<u>(302,862)</u>
Net cash provided by (used for) operating activities	<u>869,364</u>	<u>1,441</u>	<u>19,410</u>	<u>890,215</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Repayment of long-term debt	(224,855)			(224,855)
Interest paid	(78,303)			(78,303)
Addition to capital assets	<u>(200,432)</u>			<u>(200,432)</u>
Cash flows from capital and related financing activities	<u>(503,590)</u>			<u>(503,590)</u>
CASH FLOWS FROM NONCAPITAL AND FINANCING ACTIVITIES				
Donations			19,698	19,698
CASH FLOWS FROM INVESTING AND RELATED FINANCING ACTIVITIES				
Interest received	<u>52,399</u>	<u>70</u>	<u>7,804</u>	<u>60,273</u>
Net increase in cash and cash equivalents	418,173	1,511	46,912	466,596
Cash and cash equivalents at beginning of year	<u>1,263,307</u>	<u>27,021</u>	<u>328,504</u>	<u>1,618,832</u>
Cash and cash equivalents at end of year	<u>\$1,681,480</u>	<u>\$28,532</u>	<u>\$375,416</u>	<u>\$2,085,428</u>
Reconciliation of operating income to net cash provided by operating activities:				
Operating income (loss)	\$344,298	(\$6,473)	\$18,634	\$356,459
Adjustments to reconcile operating income to cash flows from operating activities:				
Depreciation	238,336			238,336
Change in assets and liabilities:				
Receivables	383,339			383,339
Prepaid expenses and other assets	166,935	7,914		174,849
Accounts payable	(20,469)		776	(19,693)
Compensated absences	(6,909)			(6,909)
Other accrued liabilities	(8,019)			(8,019)
Deferred revenue	<u>(228,147)</u>			<u>(228,147)</u>
Net cash provided by (used for) operating activities	<u>\$869,364</u>	<u>\$1,441</u>	<u>\$19,410</u>	<u>\$890,215</u>

See accompanying notes to basic financial statements

**ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Association of Bay Area Governments (the Association) was established in 1961 by agreement among its members—counties and cities of the San Francisco Bay Area pursuant to the Joint Exercise of Powers Act, California Government Code Section 6500, et seq. The Association is a separate entity from its members and its purpose is to serve as a permanent forum to discuss and study matters of mutual interest and concern to member jurisdictions, develop policies and action plans, and provide services and undertake actions addressing such matters.

The Association is governed by a General Assembly comprised of elected officials from member cities and counties. The General Assembly appoints an Executive Board to carry out policy decisions, approve the annual budget, appoint an Executive Director, and report to the General Assembly.

A. Reporting Entity

The Association's financial statements include the operations of the Association, ABAG Finance Corporation, and the Bay Area Leaders Addressing the Challenge of the Economy and Environment Foundation (BALANCE). These three entities are controlled by the General Assembly through the Executive Board. Each of these entities is discussed below:

The Association

The Association is a membership organization that provides a variety of planning, and other service programs for its members.

ABAG Finance Corporation

The Corporation is a non-profit public benefit corporation created on June 24, 1985 that aids members in obtaining financing by acting as a conduit in the sponsorship of credit pooling arrangements. Participating members issue debt, leases or certificates of participation (COPs) that are pooled as a single issue by the Corporation. Members' payments are pooled to repay the debt and the assets leased become the property of the member when it has paid off its debt obligation.

The Corporation is governed by a sub-committee of the Association's Executive Board, which establishes financing policies and approves each credit pooling arrangement.

BALANCE Foundation

BALANCE is a non-profit, tax-exempt corporation created on September 22, 1987, established to assist Bay Area governments in obtaining funds to study, analyze and resolve regional issues. BALANCE is governed by a Board of Directors whose appointment is controlled by the Association.

Other Affiliated Entities

Over the past two decades, the Association created a number of public purpose entities to offer various service programs. The financial activities of the entities are not included in these financial statements because these entities are not controlled by the Executive Board and the composition of their membership may be different than that of the Association. However, the Association has agreements with each of these entities to provide management, administrative and other support services. These entities and the service programs offered are described below:

**ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

ABAG Pooled Liability Assurance Network (PLAN) Corporation provides risk management, liability coverage, claims management and loss prevention services for participating members of PLAN. The Association acts as PLAN's trustee, providing promotional, administrative, and management support. PLAN paid the Association \$2,355,588 for these services and \$197,978 for contract services in the fiscal year ended June 30, 2008.

ABAG Finance Authority for Non-profit Corporations (FAN) assists non-profit corporations in obtaining financing. The Association assists FAN in issuing tax-exempt debt, it also provides administrative, and management support. FAN paid the Association \$1,257,804 for these services in the fiscal year ended June 30, 2008.

ABAG Comp Shared Risk Pool (SHARP) provides workers compensation coverage and claims management for participating members. The Association provides risk management, administrative, and management support. SHARP paid the Association \$47,742 for these services and \$24,469 for contract services in the fiscal year ended June 30, 2008.

ABAG Publicly Owned Energy Resources (POWER) provides gas energy aggregation services to participating members. The Association acts as POWER's trustee, providing promotional, administrative, and management support. POWER paid the Association \$313,074 for these services in the fiscal year ended June 30, 2008.

Separate financial statements are available for each of these entities at the Association's offices at 101 Eighth Street, Oakland, CA 94607.

B. Basis of Presentation

The Association's Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the U.S.A.

These Standards require that the financial statements described below be presented.

Government-wide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary reporting entity (the Association). These statements include the financial activities of the overall Association. Eliminations have been made to minimize the double counting of internal activities. These statements display the *business-type activities* of the Association. Business-type activities are financed in whole or in part by fees charged to external parties.

The Statement of Activities presents a comparison between direct expenses and program revenues for each function of the Association's business-type activities. Direct expenses are those that are specifically associated with a program or function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues are presented as general revenues.

**ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (Continued)

C. Major Funds

Major funds are defined as funds that have either assets, liabilities, revenues or expenses equal to ten percent of their fund-type total and five percent of the grand total. The Association's major funds are presented separately in the fund financial statements.

The Association reported all its enterprise funds as major funds in the accompanying financial statements:

Association Fund – this fund accounts for revenues and expenses of the Association.

ABAG Finance Corporation Fund – this fund accounts for revenues and expenses of the ABAG Finance Corporation.

BALANCE Foundation Fund – this fund accounts for revenues and expenses of the Bay Area Leaders Addressing the Challenge of the Economy and Environment Foundation.

D. Basis of Accounting

The government-wide financial statements are reported using the *economic resources measurement focus* and the full *accrual basis* of accounting. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

Members' dues are recognized as revenue in the year for which they are billed. Charges for members' services such as seminars, conferences and publications are recognized when the services are provided.

Program administration fees are recognized in the period when the services are rendered.

Grant reimbursements are recognized in the period the grant expenditures are made. Expenditures in excess of reimbursement are recorded as receivables if allowable under the grant, while excess reimbursements are recorded as deferred revenues.

The Association offers a number of service programs that are funded under cost-reimbursement or fee-for-service basis. Discretionary funds, comprised primarily of membership dues, amount to about 8% of total revenues. Discretionary funds are used to cover certain management and administrative expenses and may occasionally be allocated to meet local match requirements as stipulated in certain grant contracts.

Certain indirect costs are included in program expenses reported for individual functions and activities.

Applicable statements and interpretations of the Financial Accounting Standards Board (FASB) issued before November 30, 1989 may apply unless they conflict with or contradict GASB pronouncements. The Association has elected not to apply FASB pronouncements issued after November 30, 1989.

E. Compensated Absences

Compensated absences comprise vacations and are recorded as an expense when earned. The accrued liability for unused compensated absences is computed using current employee pay rates. Sick pay does not vest and is not accrued.

ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008

NOTE 2 - CASH AND INVESTMENTS

A. Carrying Amount and Fair Value

Cash and investments comprised the following at June 30, 2008:

	Cash and Cash Equivalents	Cash with Fiscal Agent	Total
<i>LAIF</i>	\$1,395,656		\$1,395,656
<i>Cash:</i>			
Cash in Banks	688,772		688,772
Certificates of deposit		\$400,588	400,588
Cash on hand	1,000		1,000
Total Cash and Investments	<u>\$2,085,428</u>	<u>\$400,588</u>	<u>\$2,486,016</u>

The Association pools cash from all sources and all funds except cash with fiscal agent so that it can be invested at the maximum yield, consistent with the principles of safety and liquidity. Individual funds can make expenditures at any time. Investments are carried at fair value.

B. Investments Authorized by the Association

The Association's Investment Policy and the California Government Code allow the Association to invest in the following, within the stated guidelines.

Authorized Investment Type	Maximum Maturity	Minimum Credit Quality	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Obligations	1 year	N/A	None	None
U.S. Agency Securities	1 year	N/A	None	None
Bankers Acceptances	180 days	N/A	40%	30%
Commercial Paper	270 days	A1/P1	10%	10%
Investment Agreements	On Demand	N/A	None	None
Repurchase Agreements	15 days	N/A	10%	None
Certificates of Deposit	1 year	N/A	10%	None
Negotiable Certificates of Deposit	1 year	N/A	30%	None
Money Market Mutual Funds	On Demand	N/A	None	None
California Local Agency Investment Fund	On Demand	N/A	None	None
Investment Trust of California (CalTRUST)	On Demand	N/A	None	None

C. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates may adversely affect the fair value of the Association's investment. Generally, the longer the maturity of an investment, the greater is the sensitivity of its fair value to changes in market interest rates.

ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008

NOTE 2 - CASH AND INVESTMENTS (Continued)

The sensitivity of the fair values of the Association's investments to market interest rate fluctuations is presented by the following maturity schedule of the Association's cash and investments:

	12 Months or less	Total
Local Agency Investment Fund	\$1,395,656	\$1,395,656
Certificates of deposit	400,588	400,588
Cash in Banks	688,772	688,772
Cash on hand	1,000	1,000
Total Cash and Investments	<u>\$2,486,016</u>	<u>\$2,486,016</u>

As of year end, the weighted average maturity of the investments in the LAIF investment pool is approximately 212 days.

D. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the Association may not be able to recover its deposits or collateral securities that are in the possession of an outside party. Under California Government Code Section 53651, depending on specific types of eligible securities, a bank must deposit eligible securities posted as collateral with its agent having a fair value of 105% to 150% of the Association's cash on deposit. All of the Association's deposits are either insured by the Federal Depository Insurance Corporation (FDIC) or collateralized with pledged securities held in the trust department of the financial institutions in the Association's name.

E. Local Agency Investment Fund

The Association is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The Association reports its investment in LAIF at the fair value amount provided by LAIF. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are maintained on an amortized cost basis. Included in LAIF's investment portfolio are collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by federal agencies, government-sponsored enterprises, and corporations.

Under California Government Code, LAIF is allowed greater investment flexibility than the Association is permitted. As such, LAIF's investment portfolio may contain investments not otherwise permitted for the Association. For funds invested in LAIF, LAIF's investment policy overrides the Association's investment policy.

ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008

NOTE 2 - CASH AND INVESTMENTS (Continued)

F. Statement of Cash Flows

For purposes of the statement of cash flows, the Association considers all highly liquid investments, including restricted investments but excluding cash with fiscal agents, with a maturity of three months or less when purchased to be cash equivalents.

NOTE 3 - CAPITAL ASSETS

All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Contributed capital assets are valued at their estimated fair market value on the date contributed.

Capital assets with limited useful lives are depreciated over their estimated useful lives. The purpose of depreciation is to spread the cost of capital assets equitably among all users over the life of these assets. The amount charged to depreciation expense each year represents that year's pro rata share of the cost of capital assets.

Depreciation expense is calculated on the straight line method over the estimated useful lives of assets, which are as follows:

Facilities and improvements	25 years
Furniture and equipment	3 to 10 years
Vehicles	5 years
Capitalized software	3 to 7 years

Capital asset balances and transactions as of June 30 are summarized below:

	2007	Additions	Retirements	2008
Capital Assets				
Facilities and improvements	\$3,197,605	\$20,000		\$3,217,605
Furniture and equipment	679,895	129,311	(\$15,563)	793,643
Vehicles	84,383	17,977		102,360
Capitalized software	1,128,023	28,035		1,156,058
Total	5,089,906	195,323	(15,563)	5,269,666
Accumulated depreciation	(4,731,875)	(238,336)	20,672	(4,949,539)
Total	<u>\$358,031</u>	<u>(\$43,013)</u>	<u>\$5,109</u>	<u>\$320,127</u>

**ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

NOTE 4 - LONG TERM DEBT

A. Additions and Retirements

The Association's debt issues and transactions are summarized below and discussed in detail thereafter:

	Balance June 30, 2007	Retirements	Balance June 30, 2008	
			Current Portion	Long-term Portion
BUSINESS-TYPE ACTIVITY DEBT				
MetroCenter				
Variable at TENR, + .375% 12/1/09	\$685,000	\$215,000	\$225,000	\$245,000
Equipment				
11.0-12.5%, repaid June 2008	9,855	9,855		
Total Association Long-Term Debt	<u>\$694,855</u>	<u>\$224,855</u>	<u>\$225,000</u>	<u>\$245,000</u>

B. Repayment Requirements

At June 30, 2008, future debt service requirements (based on a 1.65% rate for the MetroCenter obligation) for the Association's long-term debt were as follows:

For the Year Ending June 30	Principal	Interest
2009	\$225,000	\$7,761
2010	245,000	4,043
Total	<u>\$470,000</u>	<u>\$11,804</u>

C. 1984 MetroCenter Sale-Leaseback Agreement

Under the terms of a 1984 sale-leaseback agreement, the Association sold its MetroCenter offices to the City of Oakland and leased them back until 2009. At the end of the lease, ownership of ABAG's share of the MetroCenter building will revert to the Association. The Association received \$3,300,000 on the sale from the issuance of Liquidity Facility Revenue Bonds, which it is repaying in the form of rent payments to the City of Oakland. The outstanding principal balance of these Bonds was \$470,000 at June 30, 2008. Interest at a variable rate that was 1.65% at June 30, 2008, is due quarterly; principal is due annually.

The Liquidity Facility Revenue Bonds and related capital lease obligations are due December 1, 2009, subject to mandatory annual sinking fund payments and subject to prior redemption as a whole or in part. Interest is variable at TENR plus .375% (TENR is an annual rate of interest which is indicative of current yields on high quality short-term, tax exempt obligations) and adjustable in the future by a Remarketing Agent, and is payable quarterly. The interest rate is convertible to a fixed rate at the option of the Association.

**ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008**

NOTE 4 - LONG TERM DEBT (Continued)

D. Equipment Purchase Agreements

The Association had several non-cancelable copier lease agreements. The Association agreed to pay the leases in monthly payments of \$749 with terms that extend through 2008. Ownership of the copiers reverts to the Association at the end of the leases. Since the leases are in essence financing arrangements, the cost of the copiers and the unpaid balance the leases have been included in the Association's financial statements.

E. Line of Credit

The Association has a \$1 million line of credit arrangement with a bank. No borrowings were made on the line of credit during fiscal year 2008.

NOTE 5 - WINDEMERE RANCH ASSESSMENT DISTRICT SPECIAL ASSESSMENT DEBT

On behalf of Contra Costa County, the Association formed the Windemere Ranch Assessment District in an unincorporated area of that County. The District issued special assessment debt to fund infrastructure improvements as part of the development of residential housing in the District.

These debt issues are repayable out of special assessments on the parcels in the District, and are secured by liens on each parcel. The Association has no obligation for the repayment of the District's assessment debt, and accordingly, does not record this debt in its financial statements.

The outstanding balance of each of the District's debt issues has been refunded by new debt issued on June 26, 2007 by the ABAG Financing Authority for Nonprofit Corporation. The Association has no obligation for the repayment of these new revenue bonds, therefore has not recorded this debt in its financial statements.

NOTE 6 - CONDUIT FINANCING PROGRAMS FOR MEMBERS

The Association assists members and other borrowers in obtaining financing through the issuance of revenue bonds, special assessment debt, certificates of participation in lease revenues and in straight leasing arrangements.

The underlying liability for the repayment of each of these issues rests with the borrower participating in that issue, and not with the Association, which act only as a conduit in pooling each issue. For that reason, the Association has not recorded a liability for these issues. The Association sponsored the following outstanding conduit debt balances that were payable by their respective borrowers at June 30, 2008:

Type of Financing	Unpaid balance - June 30	
	2008	2007
Revenue Bonds	\$278,255,000	\$104,690,000
Certificates of Participation	43,460,000	48,240,000
Total	<u>\$321,715,000</u>	<u>\$152,930,000</u>

ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008

NOTE 7 – NET ASSETS

Net Assets

Net Assets is the excess of all the Association's assets over all its liabilities, regardless of fund. The Association's Net Assets are divided into the two captions described below:

Restricted describes the portion of Net Assets which is restricted as to use by the terms and conditions of donations received by the Association. As of June 30, 2008, the entire amount in Restricted Net Assets is restricted for the support of the Tranter-Leong Internship Program.

Unrestricted describes the portion of the Net Assets which may be used for any Association purpose.

NOTE 8 - PENSION PLAN

All Association employees are eligible to participate in pension plans offered by California Public Employees Retirement System (CALPERS), an agent multiple employer defined benefit pension plan which acts as a common investment and administrative agent for its participating member employers. CALPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. The Association's employees participate in the Miscellaneous Employee Plan. Benefit provisions under the Plan are established by State statute and Association resolution. Benefits are based on years of credited service, equal to one year of full time employment. Funding contributions for the Plan are determined annually on an actuarial basis as of June 30 by CALPERS. The Plan's provisions and benefits in effect at June 30, 2008, are summarized as follows:

	<u>Miscellaneous</u>
Benefits vesting schedule	5 years service
Benefits payments	Monthly for life
Retirement age	50
Monthly benefits, as a % of annual salary	2 % - 2.5%
Required employee contribution rates	8.00%
Required employer contribution rates	19.194%

CALPERS determines contribution requirements using a modification of the Entry Age Normal Method. Under this method, the Association's total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this method is the level amount the Association must pay annually to fund an employee's projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The actuarial assumptions used to compute contribution requirements are also used to compute the actuarial accrued liability. The Association does not have a net pension obligation since it pays these actuarially required contributions monthly.

CALPERS uses a market related value method of valuing the Plan's assets. Investment gains and losses are accumulated as they are realized and ten percent of the net balance is amortized annually. An investment rate of return of 7.75% is assumed, including inflation at 3%. Annual salary increases are assumed to vary by duration of service. Changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methods are amortized as a level percentage of payroll on a closed basis over twenty years.

ASSOCIATION OF BAY AREA GOVERNMENTS
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2008

NOTE 8 - PENSION PLAN (Continued)

Actuarially required contributions for fiscal years 2008, 2007, and 2006, were \$1,667,933, \$1,595,500, and \$1,420,145, respectively. The Association made these contributions as required, together with certain immaterial amounts required as the result of the payment of overtime and other additional employee compensation

As required by new State law, effective July 1, 2005, the Association's Miscellaneous Plan was terminated, and the employees in the plan were required by CALPERS to join a new State-wide pool. One of the conditions of entry to the pool was that the Association true-up any unfunded liabilities in the former Plan, either by paying cash or by increasing its future contribution rates through a Side Fund offered by CALPERS. The Association will fund the liability through increased future contribution rates.

The State-wide pool's actuarial value and funding progress over the past three years are set forth below at the actuarial valuation date of June 30:

Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as % of Payroll
2004	\$434,267,445	\$379,807,592	\$54,459,853	87.5%	\$97,227,479	56.0%
2005	579,276,103	500,388,523	78,887,580	86.4%	129,379,492	61.0%
2006	912,988,585	787,758,909	125,229,676	86.3%	200,320,145	62.5%

Audited annual financial statements are available from CALPERS at P.O. Box 942709, Sacramento, CA, 94229-2709.

NOTE 9 - COMMITMENTS AND CONTINGENT LIABILITIES

The Association participates in Federal and State grant programs. These programs have been audited by the Association's independent accountants through the fiscal year ended June 30, 2008, in accordance with the provisions of the Federal Single Audit Act Amendments of 1996 and applicable State requirements. No cost disallowances were proposed as a result of these audits; however, these programs are still subject to further examination by the grantors and the amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time. The Association expects such amounts, if any, to be immaterial.

**ASSOCIATION OF BAY AREA GOVERNMENTS
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2008**

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ASSOCIATION OF BAY AREA GOVERNMENTS
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2008

Table of Contents

	<u>Page</u>
<i>Memorandum on Internal Control</i>	1
Schedule of Significant Deficiencies	2
Schedule of Other Matters	3
<i>Required Communications</i>	7
Financial Statement Audit Assurance	7
Other Information Included with the Audited Financial Statements	7
Accounting Policies	7
Unusual Transactions, Controversial or Emerging Areas	8
Estimates	8
Disagreements with Management	8
Retention Issues	8
Difficulties	8
Audit Adjustments	8
Uncorrected Misstatements	8

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MEMORANDUM ON INTERNAL CONTROL STRUCTURE

September 26, 2008

To the Executive Board of the
Association of Bay Area Governments
Oakland, California

In planning and performing our audit of the financial statements of the Association of Bay Area Governments as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the Association's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We noted no matters that we consider to be material weaknesses, however, we identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the Association.

The Association's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, Association Board, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

**ASSOCIATION OF BAY AREA GOVERNMENTS
MEMORANDUM ON INTERNAL CONTROL STRUCTURE**

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-01 – Accounting Oversight & Review

The Association's former Assistant Finance Director left the Association's employment in fiscal 2007-08 and has not yet been replaced. This position was vacant during the period under audit and provides key oversight and controls over the accounting function. The absence of this position raises the potential that a significant error could occur and not be timely detected and corrected by existing staff.

The operations of ABAG and its affiliates are diversified, complex and very unusual which increases the need for a qualified Assistant Finance Director to oversee the accounting staff. Many of the oversight functions have been assumed by the incoming Finance Director on a temporary basis. However, both functions will be needed in the future to ensure that procedures are effective and efficient and controls do not deteriorate.

Management Response:

During FY 07-08, the former Finance Director announced his plan to retire after 25 years of service and the Association started recruiting for a new Finance Director. The recruitment was successful and a qualified and experienced successor took over the Finance Director position on July 2, 2008. The former Assistant Finance Director resigned from the Association in January 2008 and that position has not yet been filled to date. Recognizing the increased risk in internal control due to the departure of the Assistant Finance Director, the former Finance Director agreed to stay on to support his successor until the Assistant Finance Director position is filled. During that six-month period, the Association managed to maintain an adequate level of checking and balancing within the Finance Department, and as the results of the audit process for FY 07-08 have shown, there are no audit findings or material weaknesses to report.

ASSOCIATION OF BAY AREA GOVERNMENTS
MEMORANDUM ON INTERNAL CONTROL STRUCTURE

SCHEDULE OF OTHER MATTERS

2008-02 – Information Technology Best Practices

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We significantly expanded our work from previous years beyond looking solely at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over financial systems. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards which local governments are required to conform to. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments may use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

A summary of our results and “best practices” recommendations are as follows:

- *External Scan Results:* We performed an external scan based on PCIE standards (See below) and found exploitable vulnerabilities in the Association’s externally facing systems (systems connected directly to the Internet) which may be used to gain control of those systems. Externally facing systems should have the greatest level of security. These vulnerabilities should be mitigated as soon as possible. In addition, the Association should establish a means to monitor the effectiveness of their information systems control procedures, including periodic vulnerability scans. If the vulnerabilities cannot be patched other mitigating controls such as host based firewalls can be used.
- *Internal Scan Results:* Because of these external vulnerabilities, we performed a secondary scan of internal financial systems to determine if there were vulnerabilities to the financial systems. Our internal scan found exploitable vulnerabilities in the Association’s financial application server and one randomly selected workstation which potentially could permit unauthorized access to data. These vulnerabilities should be mitigated as soon as possible. In addition, the Association should establish a means to monitor the effectiveness of their information systems control procedures, including periodic vulnerability scans. If the vulnerabilities cannot be patched other mitigating controls such as host based firewalls can be used.

ASSOCIATION OF BAY AREA GOVERNMENTS

MEMORANDUM ON INTERNAL CONTROL STRUCTURE

SCHEDULE OF OTHER MATTERS

- *Payment Card Industry Compliance* - Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees than those that do not comply and they minimize their liabilities which may result from security breaches. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:
 1. Fill out a self-assessment questionnaire (SAQ).
 2. Submit the SAQ to acquiring banks.
 3. Perform quarterly external network scans and submit the results to acquiring banks.
 4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

We believe the Association qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants within the near future. Staff have not completed the SAQ, but should do so and prepare for the submission requirement.

- *General Information Systems Controls* - We compared the Association's information systems controls with the various NIST standards and believe improvements should be considered for implementation such as formalizing business continuity plans including alternate processing site locations, contingency planning and training. We provided a detailed report to the Association Auditor and the Association's Administrative Services staff which describes the relevant standards and the control status for their consideration.

As noted above, the Association is not required to conform to NIST standards and could use another set of guidelines to ensure the adequacy of controls. However, we recommend the Association select an appropriate industry standard such as NIST to plan, organize and monitor information security proactively.

Management Response:

- *External Scan* The Association recognizes the critical nature of Internet and computer network security. ABAG utilizes a robust and actively maintained firewall. In response to the auditors' recommendation, staff will continue to review and update this firewall to ensure that the identified vulnerabilities will be minimized.
- *Internal Scan* Staff is in the process of applying patches to the Association's financial system and server to mitigate the identified vulnerabilities on the auditors' report.
- *Payment Card Industry Compliance* The Association does accept a number of credit cards for payment of its conferences, training seminars and publications. Management believes that these transactions should always comply with the latest security standards, and will follow the recommended security measures going forward.

ASSOCIATION OF BAY AREA GOVERNMENTS

MEMORANDUM ON INTERNAL CONTROL STRUCTURE

SCHEDULE OF OTHER MATTERS

- *General Information System Controls* The Association believes in proactively planning for disaster recovery. Several years ago, ABAG adopted a Business Recovery Plan, and recently have been conducting Workplace Emergency Procedures training jointly with the Metropolitan Transportation Commission (MTC). In addition, staff is in the process of implementing a remote data backup system located at the offices of the California State Association of Counties (CSAC) in Sacramento.

2008-03 – Investment Policy Update

The Association's investment policy requires an annual update process that was not completed during fiscal 2007-08. This process should be completed as required or the policy should be changed to remove the annual update requirement.

Management Response:

In response to this recommendation, staff presented and the Executive Board approved at its September 2008 meeting an amendment to the Association's investment policy requiring an update only when a revision to the policy is sought. Investment reports will continue to be presented to the Finance Committee and Executive Board on a bi-monthly basis.

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ASSOCIATION OF BAY AREA GOVERNMENTS

REQUIRED COMMUNICATIONS

September 26, 2008

To the Executive Board of the
Association of Bay Area Governments
Oakland, California

We have audited the financial statements of the Association of Bay Area Governments as of and for the year ended June 30, 2008 and have issued our report thereon dated September 26, 2008. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the Association's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the Association is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. As described in notes to the financial statements, during the year, the Association implemented GASB Statement No. 50 *Pension Disclosures* — *an amendment of GASB Statements No. 25 and No. 27* - This Statement amends current disclosures for cost sharing defined benefit pension plans by requiring among other things, funding trend data for cost sharing pools. Note 8 to the financial statements was modified and enhanced primarily by the inclusion of trend funding tables for the State-wide pools the Association participates in.

ASSOCIATION OF BAY AREA GOVERNMENTS

REQUIRED COMMUNICATIONS

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are unbilled receivables. The Association has recorded unbilled receivables approximating \$1.6 million. Actual billings and the ultimate collections may vary from this estimate.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the Association's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the Association's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the Association, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the Association that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the entity's financial reporting process.

ASSOCIATION OF BAY AREA GOVERNMENTS

REQUIRED COMMUNICATIONS

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the audit committee.

This report is intended solely for the information and use of the Association Board, its committees, and management and is not intended to be and should not be used by anyone other than these specified parties.

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ASSOCIATION OF BAY AREA GOVERNMENTS

**SINGLE AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2008**

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ASSOCIATION OF BAY AREA GOVERNMENTS

SINGLE AUDIT REPORT
For The Year Ended June 30, 2008

TABLE OF CONTENTS

	<u>Page</u>
Schedule of Findings and Questioned Costs.....	1
Section I - Summary of Auditor's Results.....	1
Section II – Financial Statement Findings.....	2
Section III – Federal Award Findings and Questioned Costs.....	2
Section IV - Status of Prior Year Findings and Questioned Costs.....	2
Schedule of Expenditures of Federal Awards.....	4
Notes to Schedule of Expenditures of Federal Awards.....	6
Report On Internal Control over Financial Reporting and On Compliance And Other Matters Based on an Audit of Financial Statements Performed In Accordance With <i>Government Auditing Standards</i>	7
Report On Compliance with Requirements Applicable To Each Major Program and On Internal Control Over Compliance In Accordance With OMB Circular A-133	9

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ASSOCIATION OF BAY AREA GOVERNMENTS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended June 30, 2008

SECTION I—SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? Yes X No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? X Yes None Reported

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Type of auditor's report issued on compliance for major programs: Unqualified

Internal control over major programs:

- Material weakness(es) identified? Yes X No
- Significant deficiency(ies) identified that are not considered to be material weaknesses? Yes X None Reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133? Yes X No

Identification of major programs:

CFDA#(s)	Name of Federal Program or Cluster
66.461	Environmental Protection Agency Wetland Grant
66.456	Environmental Protection Agency Estuary Grant

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? X Yes No

SECTION II – FINANCIAL STATEMENT FINDINGS

Our audit disclosed a significant deficiency but no material weaknesses or instances of noncompliance material to the basic financial statements which has been included in our separately issued Memorandum on Internal Control dated September 26, 2008. This Memorandum is an integral part of our audits and should be read in conjunction with this report.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Our audit did not disclose any findings or questioned costs required to be reported in accordance with section 510(a) of OMB Circular A-133.

SECTION IV - STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS –

Prepared by Management

Financial Statement Prior Year Findings

There were no prior year Financial Statement Findings reported.

Federal Award Prior Year Findings and Questioned Costs

2007-01: Environmental Protection Agency CFDA 66.461 Wetland Grant – Subrecipient Monitoring

According to the OMB Circular A-133 Compliance Supplement, the Association is required to include provisions in sub-award documents which require subrecipients to comply with federal regulations, including Circular A-133, Audits of States, Local Governments and Non-profit Organizations, which requires a Single Audit in certain circumstances. However, the contract between the Association and the subrecipient under this program does not include such a provision. In addition, it is important that the Association monitor the subrecipient's activities and review the subrecipient's Single Audit (if applicable) on a timely basis.

Current Status:

The Association did contact EPA regarding submitting a revised contract with the sub-recipient in question, and was informed by EPA that such revision was not necessary since that grant to the Association had been completed and closed. However, the Association has revised its sub-recipient contract template to include the necessary provisions required by OMB Circular A-133 for future sub-recipient contracts.

2007-02: Department of Commerce CFDA 11.419 CIAP – Bay Trail Construction – Interest on Advances

Although this is a pass-through grant from State, the Association is required by the OMB Circular A-133 Compliance Supplement to return interest earned on advances. The Association received an advance for this program in June 30, 2005 and has invested it the Local Agency Investment Fund, which earns interest. We have estimated that since the advance was received, the Association has earned interest approximating \$27,000 on the advance but has not returned the interest to the grantor. This interest should be returned to the grantor unless the Association receives authorization to apply it to program expenditures.

Current Status:

The Association calculated the amount of interest income attributable to the cash advances from the grant in question to be \$25,700 as of June 30, 2007. Accordingly, an adjustment was made in the Association's books to increase the fund balance (deferred revenue) of this project by the same amount, thereby making it available to cover project expenses. Following the same procedure, the Association determined the amount of interest income for fiscal year ending June 30, 2008 to be \$10,929, and the same adjustment to project fund balance was reflected as of June 30, 2008.

**ASSOCIATION OF BAY AREA GOVERNMENTS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

For the Fiscal Year Ended June 30, 2008

<u>Federal Agency & Program Name</u>	<u>Identifying Pass-Through #</u>	<u>Federal Catalog Number</u>	<u>Federal Expenditures</u>
Department of Transportation (Passed-through the Metropolitan Transportation Commission)			
Highway Planning and Construction Program			
Federal Highway Administration			
Information Analysis		20.205	\$536,333
Planning Services		20.205	627,079
Focusing the Bay Area Vision		20.205	351,016
Federal Transit Administration			
Information Analysis		20.205	111,962
Planning Services		20.205	130,906
Program Subtotal			<u>1,757,296</u>
Federal Aviation Administration			
Airport Improvement Program			
FAA Airport Study	CA-81-X003	20.505	<u>29,251</u>
Program Subtotal			<u>29,251</u>
Federal Department Subtotal			<u>1,786,547</u>
Department of the Interior			
US Geological Survey			
U.S. Geological Survey_ Research And Data Collection			
USGS 2007 SOE	07WRGR0006	15.808	25,037
US Fish & Wildlife Service			
Fish And Wildlife Management Assistance			
Pacific Marine Fisheries	1448601815G047	15.608	<u>7,416</u>
Federal Department Subtotal			<u>32,453</u>
Environmental Protection Agency			
Regional Wetland Program Development Grants			
EPA Tracker Expansion	CD-96946701-1	66.461	72,095
EPA Stream/Wetland	CD-96946801	66.461	20,429
EPA Stream II	CD-00T00401-0	66.461	103,069

**ASSOCIATION OF BAY AREA GOVERNMENTS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

For the Fiscal Year Ended June 30, 2008

Federal Agency & Program Name	Identifying Pass-Through #	Federal Catalog Number	Federal Expenditures
Subtotal			<u>195,593</u>
National Estuary Program			
EPA--FY0 06-07 Estuary	CE-96949401-1	66.456	167,492
EPA--FY 07-08 Estuary	CE-96949401-3	66.456	<u>247,532</u>
Subtotal			<u>415,024</u>
Federal Department Subtotal			<u>610,617</u>
Department of Agriculture			
Integrated Programs			
USDA IPM	2003-51120.02098	10.303	<u>37,448</u>
Federal Department Total			<u>37,448</u>
Department of Homeland Security			
Federal Emergency Management Agency			
FEMA--Soft Story Grant	1646-2-1	97.039	20,269
FEMA--Water Supply Grant	1628-40-18	97.039	<u>38,281</u>
Federal Department Total			<u>58,550</u>
Department of Commerce			
National Oceanic & Atmospheric Administration			
(Passed through San Francisco Bay Conservation and Development Commission)			
Coastal Zone Management Administration Awards			
SFEP SubTidal Goals	AB 133F-07-SE-3935	11.419	<u>1,166</u>
Total Federal Expenditures			<u><u>\$2,526,781</u></u>

See Accompanying Notes to Schedule of Expenditures of Federal Awards

ASSOCIATION OF BAY AREA GOVERNMENTS

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For The Year Ended June 30, 2008

NOTE 1-REPORTING ENTITY

The Schedule of Expenditure of Federal Awards (the Schedule) includes expenditures of federal awards for the Association of Bay Area Governments, California only and its component units as disclosed in the notes to the Basic Financial Statements.

NOTE 2-BASIS OF ACCOUNTING

Basis of accounting refers to *when* revenues and expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. All proprietary funds are accounted for using the accrual basis of accounting. Expenditures of Federal Awards reported on the Schedule are recognized when incurred.

NOTE 3-DIRECT AND INDIRECT (PASS-THROUGH) FEDERAL AWARDS

Federal awards may be granted directly to the Association by a federal granting agency or may be granted to other government agencies which pass-through federal awards to the Association. The Schedule includes both of these types Federal award programs when they occur.

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Executive Board of the
Association of Bay Area Governments
Oakland, California

We have audited the financial statements of the Association of Bay Area Governments as of and for the year ended June 30, 2008, and have issued our report thereon dated September 26, 2008. We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Association's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Association's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Association's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Association's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Association's financial statements that is more than inconsequential will not be prevented or detected by the Association's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Association's internal control.

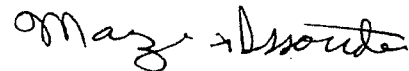
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Association's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

However, our audit disclosed a significant deficiency but no material weaknesses or instances of noncompliance material to the basic financial statements which has been included in our separately issued Memorandum on Internal Control dated September 26, 2008. This Memorandum is an integral part of our audits and should be read in conjunction with this report.

This report is intended solely for the information and use of Association Board, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



September 26, 2008

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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

To the Executive Board of the
Association of Bay Area Governments
Oakland, California

Compliance

We have audited the compliance of the Association of Bay Area Governments with the types of compliance requirements described in the OMB Circular A-133 *Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Association's major federal programs are identified in Section I - Summary of Auditor's Results included in the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Association's management. Our responsibility is to express an opinion on the Association's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Association's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Association's compliance with those requirements.

In our opinion, the Association complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

Internal Control over Compliance

The management of the Association is responsible for establishing and maintaining effective internal controls over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Association's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Association's internal control over compliance.

A *control deficiency* in an Association's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Association's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Association's internal control.

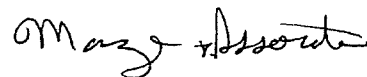
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Association's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Association as of and for the year ended June 30, 2008, and have issued our report thereon dated September 26, 2008. Our audit was performed for the purpose of forming opinions on the financial statements. The accompanying schedule of expenditures of federal awards is presented for the purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of Association Board, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



October 26, 2008